Transnationals

Quarterly Newsletter of the United Nations Centre on Transnational Corporations

NEW SOVIET CHART OF ACCOUNTS

Concluding two years of work, the international task force charged with incorporating market principles into Soviet accounting signed off on its draft for a new national chart of accounts and recommended its use by domestic enterprises. The chart was approved in October by the then Soviet Ministry of Finance, and will be considered for adoption independently by the Republics.

The new chart enables domestic entrepreneurs and foreign investors to report their financial results according to international accounting standards. Potential investors will find it more easy to determine the profitability of local enterprises.

The task force comprised experts from the Intergovernmental Working Group on International Standards of Accounting and Reporting (ISAR), the Soviet Union, and representatives from international accounting firms such as Moore Stephens, Deloitte Touche and KPMG. It was convened by UNCTC and the Ministry of Finance, and was initially asked to modify accounting standards so as to simplify reporting by foreign joint ventures. Diverging accounting practices between domestic and foreign partners were creating operational hurdles, which were impeding investments, and there were calls for harmonized standards.

Anatoly Sheremet, Professor, Moscow State University/President, Association of Accountants.

Nikolai Panteleev, Head, Department of Accounting, Ministry of Finance.

But given the dramatic political and economic shifts within the Soviet Union in the last few months, the scope of revisions was broadened. The new standards apply not only to joint ventures but to all enterprises and organizations throughout the country, except financial and non-profit institutions.

The modernized chart introduces new concepts like accrual accounting, period costs, and accounting for intangibles. It does away with most prac-

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Cuba Invites Investors

Following world economic trends, the Government of Cuba is promoting foreign investment more actively than in the past. Like many other developing countries, Cuba is seeking investment in activities that will expand exports of goods and services. Latin American investors are especially welcome.

Investments are being sought particularly in tourism and related industries, in sugar by-products, citrus industries, pharmaceuticals and biotechnology, and electronics.

Tourism has generated the most investment by far. The largest project is Sol y Palmeras, a joint venture with investors from Spain. According to the Spanish co-manager, Cuban authorities have been very flexible in adapting regulations to the needs of an industry which is one of the most competitive in the world. For example, in keeping with national law, the venture was initially prevented from

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Soviet Chart

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tices associated with "fund" accounting and proposes new formats for balance sheets, income and other financial statements.

Work will continue to resolve issues of currency convertability, inflation, and differences between tax and financial accounting.

John Gruner, Executive Director, International Federation of Accountants.

Work will continue, to resolve issues that the draft chart does not tackle. Among these are the need for more comprehensive accounting standards on intangible assets, financial instruments, depreciation, inflation, leasing and foreign currency translation. Other concerns relate to privatization and the difference between tax accounting and financial accounting. The task force recommended that an international advisory board on accounting be set up under the auspices of the Inter-Republican Economic Committee, interested Republics and UNCTC. ■

Cuba

(Continued from page 1)

granting special incentives to encourage worker productivity. But seeing the constraints, the regulation was soon removed.

Cubanacan, the state-owned company which is the local partner in all tourism joint ventures, is currently managing over $430 million in new hotels. Foreign investment comes mostly from Spain. Jamaica and Germany are other active investors.

Investments are starting to flow to other sectors as well. France's Totale has signed a contract for oil exploration. Talks have been initiated with Japan on a mechanism — similar to debt-equity swaps — by which Cuba might meet its debt obligations to Japan.

Focus on Latin America

Cuba's foreign investment legislation, Law 50, was passed in February 1982. But it was little used until 1988, when investments in tourism started to multiply.

At the same time, Eastern European countries, which had accounted for about 85 per cent of Cuban trade, moved from barter and countertrade to trade on a hard currency basis. Cuba's external commercial relations were badly eroded.

In reorienting economic ties, Cuba is focusing on Latin America. Consular and commercial relations have been re-estab-

Latin American investors are allowed 100 per cent equity ownership. The response has been positive.

lished with Chile, Colombia and Paraguay. Since mid-October, Latin American investors are allowed 100 per cent equity ownership in Cuban enterprises. The response has been very positive.

Negotiations are underway with oil-exporting Mexico, Colombia and Venezuela and an arrangement for oil sales to Cuba is being discussed. Private sector representatives from several Latin American countries are travelling to Cuba in search of investment opportunities.

Law 50 allows foreign investment through joint ventures with state-owned enterprises. Equity participation is limited to a maximum of 49 per cent. But up to 100 per cent ownership may be granted on a case-by-case basis, even to investors from outside the region. In the last two years, several tourism joint ventures with

Law 50 Highlights

- Joint ventures with state-owned enterprises
- 49 per cent foreign ownership; up to 100 per cent on a case-by-case basis
- No limits on profit remittances
- No income tax
- Freedom in import and export
- Access to local financing

READEX FICHE

50 per cent foreign ownership have been approved.

Joint ventures must be approved by the Comité Estatal de Colaboración Económica. The foreign partner may be required to provide a financial guarantee that investment will take place. The Government pays market-rate interest on this guarantee. On approval, both guarantee and interest are released. If the proposal is denied, it is released within 60 days.

The newly formed company is "completely independent from the state". It is free to export directly to markets abroad and to import needed inputs. It may set its board of directors as it sees fit. It may hire Cuban labour from a pool of workers presented by a Cuban entity. However, worker contractual relations must be with the Cuban partner or the government agency providing the workers.

Law 50 sets no limits on remittances of dividends and profits. However, authorities have the right to keep the remittances of foreign personnel within a certain percentage of their salary. Companies and their personnel are exempt from taxes on gross income, personal income and transfer of real estate and commercial establishments.

Taxes, as well as any other financial operation, must be transacted in freely convertible currency. The tax on net annual profits is 30 per cent. There are some deductibles. Foreign investors are eligible to borrow from the National Bank of Cuba, as well as from banks abroad.

UNCTC is supporting Cuba's initiative to promote foreign investment with training workshops on marketing and organizational design, and advisory assistance regarding the establishment of joint ventures with foreign partners in a number of fields. ■

Services Tradeability Creates Developing Country Opportunities

The merger of computer and telecommunication technologies is making data services increasingly tradeable across borders. Modern computer communications networks allow instantaneous interactive transactions over thousands of miles. The implications for international trade in services, the structure of the global services economy, and for developing countries, could be significant.

The new technologies have particular applicability in the area of business services — banking and financial services, insurance, engineering, data services, accounting, consultancy, advertising, legal services, research and development, market research, and architectural services. For example, a substantial number of banking services ranging from payment of bills to provision of cash and mortgage lending are now available electronically to customers located at a distance.

Data Services

- Data processing
- Software
- Digital telecommunications
- Information storage and retrieval

Cross-border tradeability is likely to expand the global division of labour in information-intensive services, altering existing supply patterns and the structure of individual industries. Moreover, it enhances the opportunities for developing countries to participate in areas where they have comparative advantages. The labour-intensive part of many business services, such as the processing of cheques in banking and of claims in insurance, could be undertaken in countries where labour is cheap and the required infrastructure and skills are available.

Services sub-contracting and offshore production are already underway in several developing countries.

Already, services sub-contracting and offshore production are underway in several developing countries. The data-processing and software development operations of IBM in the Philippines, and the data-entry operations of American Airlines in the Caribbean are just two examples.

For developing countries, telematic technologies are widening the scope of available services, and at more competitive prices. Previously, most services were not tradeable or transportable as goods are. They could only be delivered across borders by setting up affiliates abroad. Now they may be provided without a foreign presence.

Access to specialized services could enhance the competitiveness of the export sector and of the economy as a whole. Detailed market information, for instance, would help strengthen export operations. Or, if foreign insurance can be purchased at lower cost or superior quality, entrepreneurs may be willing to undertake projects which are more risky.

As part of its research programme in this area, UNCTC will examine the implications of the tradeability of services for global trade and foreign direct investment, particularly in developing countries. ■

Global Fall Out of Transnational Bank Closure

When a transnational bank fails, a number of interests must be safeguarded — depositors, creditors, shareholders, employees and others. How is this to be done? What new regulatory mechanisms need to be instituted to supplement or replace existing national arrangements? What new procedures must be established?

"Much like Bhopal or Chernobyl in the area of the environment and industrial safety, the 5 July closure

G. Arthur Brown, Governor, Central Bank of Jamaica.

of the Bank of Credit and Commerce International (BCCI) and its fall out have brought to the forefront a number of issues", said Kamal Hossain, special advisor to UNCTC. Key among these is the absence of any international machinery to deal with such an event.

The closure affected 1.3 million customers in all parts of the world. The bank had units in over 73 countries, upwards of 425 offices and more than 14,000 employees of 83 nationalities. Its asset base was over $20 billion.

In consultation with UK authorities, on 29 November 1991, UNCTC convened a special meeting in London to consider issues of transnational bank failure. Fifteen experts were invited including authorities from the legal and accountancy professions, Central Bank Governors from Jamaica, Nigeria and the Philippines, and Zambia's Director of Bank Supervision. Recommendations for action emerged on some urgent matters, in an initiative to place them on the international agenda.

"International banking transactions are increasing", said Peter Hansen, Executive Director, UNCTC. "We see the need for more cooperation between Governments and for greater exchange of information."

Remedial action at the national level may hinder the fair resolution of a problem internationally.

Protecting the Innocent

Experts underlined the need for an effective international framework to deal with the closure of transnational banks to avoid the sort of conflicts seen in the BCCI case.

In the absence of such a framework, liquidation proceedings are instituted under differing national jurisdictions in each country of operation. This is often to the detriment of innocent parties. Liquidation involves a multiplicity of legal proceedings, ring-fencing, and other defensive actions by national authorities, evasive action by borrowers and exchange controls. There are substantial expenses and delays in the resolution of claims and other issues.

It becomes difficult to realize the maximum value of assets. In the BCCI case, for example, the liquidators estimated that under existing arrangements, claimants would recover less than 40 cents on the dollar.

In the United States, the United Kingdom and Finland, the recent collapse of savings and loans institutions and commercial banks has seen governmental rescue packages running into millions of dollars. The aim is to fend off liquidation in the interest of depositors, shareholders, creditors and other innocent parties.

Such protective action has no counterpart on the global plane. In fact, remedial action at the national level may hinder the fair resolution of a problem internationally.

Deposit Insurance and Cooperation

Participants called for deposit insurance at the international level for units of transnational banks. If countries were unable to establish such funds by themselves, schemes based on cooperation by a number of countries might be promoted.

Recent experience underlined the need for greater international cooperation in supervising transnational banks. Cooperation and

information exchange between national regulatory authorities should be strengthened and extended to cover new areas. Bilateral treaties and eventually a multilateral framework, based on reciprocity, could be used to override secrecy provisions contained in national law.

External auditors should be required to assist regulatory authorities and to furnish necessary information. Canadian legislation provides a useful model in this regard.

Information and disclosure requirements, as well as auditing standards, need to be improved and harmonized. National legal and regulatory frameworks need to be updated to reflect agreement on "international" standards. Participants, and an observer from the UK Treasury, said current differences in national treatment of insolvency and accounting hampered an equitable resolution of the BCCI affair.

A spate of national legislation is likely. Governments should take care that these do not restrict the expansion of banking or international trade.

Michael Knowles, Member of Parliament, United Kingdom.

Countries need to agree on which national authority should be the primary regulator, particularly in the case of liquidation proceedings. With BCCI, for instance, most country units were operating on a self-sufficient basis. Allegations of delinquency relate primarily to the Grand Cayman branch. But a number of countries — including Nigeria, Kenya, Egypt and Mauritius — have taken unilateral national action to restructure the BCCI units on their territories under different names and management. Experts at the London meeting recommended that the country where the bank has its centre of operations and its main business be the primary authority.

Interim Arrangements

Until an international framework is developed, participants proposed some special arrangements to handle transnational bank failure. Among these were the kind of compensation plan being negotiated in the BCCI case with contributions from shareholders, and the establishment of a board of international trustees. These would provide an international umbrella to liquidators enabling them to devise a global settlement plan that best preserved going concern values and the interests of innocent parties.

Kamal Hossain, former Minister of Law, Bangladesh.

A spate of national legislation is likely in the wake of recent developments. Governments should take care that these do not restrict the growth of banking or the expansion of international trade, particularly of developing countries.■

Recommendations for Future Reforms

- Strengthened cooperation in banking supervision
- Effective information exchange
- Harmonized standards and definitions
- Updating national frameworks
- External auditors to assist regulatory authorities
- Information and disclosure requirements
- Technical assistance and training

Angola Peace Accord Eases Climate for Investment

Angola is potentially one of Africa's richest countries. With abundant mineral wealth and hydro-electric power, its industrial sector at independence in 1975 was second only to Kenya. The country is a significant oil producer, and was once the world's fourth largest exporter of coffee.

Even through the 15-year civil war, foreign capital poured in to the high-return petroleum and diamond sectors. Petroleum is now Angola's prime export, accounting for 91 per cent of total foreign sales (about $2.7 billion in 1989). Diamonds are the second largest export. Angola has a trade surplus of $1.8 billion.

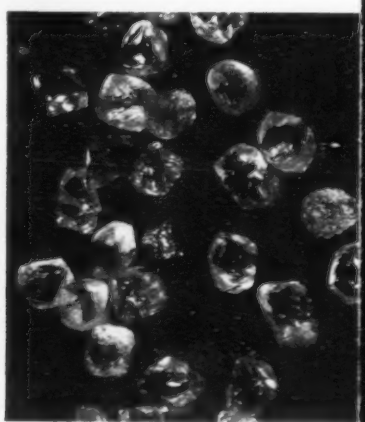
However, the economy's overwhelming reliance on these sectors is precarious. In 1988, as part of a broader diversification initiative, the Government passed the Foreign Investment Act. It opened the Angolan economy to overseas investors and offered key guarantees. Foreign investments in the oil and mining sectors are regulated by prior individual laws.

Investments did not pick up as desired. But the ceasefire accord of May 1991 will markedly change business conditions, if economic policy distortions, including exchange rates, are corrected. Additionally, the national reconstruction process launched by the accord gives particular importance to foreign capital.

Even through the civil war, foreign capital poured into the high-return petroleum and diamond sectors.

Priority Investment Areas

- Agriculture and food production
- Fishing and livestock
- Mining
- Light industry
- Consumer goods
- Housing



Streamlined Approvals Process

Under the Foreign Investment Act, joint ventures are permitted with public or private Angolan companies. Equity may be in the form of capital, capital goods and technology. One hundred per cent foreign ownership is also permissible.

Investors are guaranteed full repatriation of capital and dividends. They may transfer abroad capital from the sale or liquidation of a company. They can use domestic sources of credit.

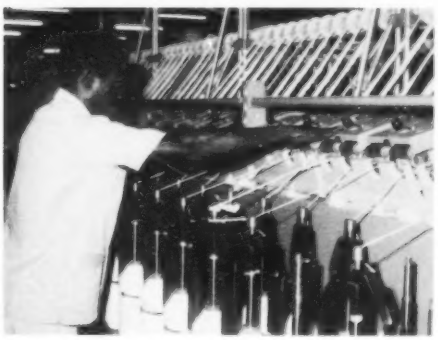
In 1989, the Gabinete do Investimento Estrangeiro (GIE) was created as the focal point for foreign investors. The investor submits to GIE a Declaration of Intent to Invest, containing a broad description of the intended project; whether it is a new venture, or an expansion or rehabilitation of an existing one.

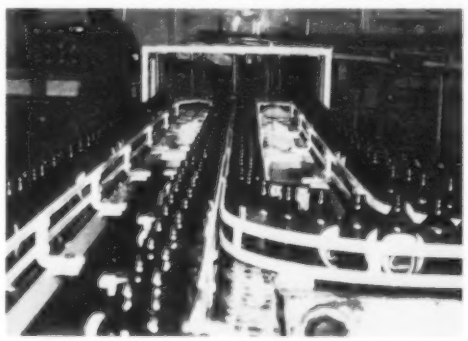
If the appropriate government ministry is interested, GIE invites the investor to submit a formal proposal and feasibility study with full economic and financial projections. A training plan for Angolan workers and managers is also essential. The GIE submits its evaluation and recommendation of the investment proposal to the Minister of Planning, who presents it to the Council of Ministers for final approval.

Noteworthy Investor Response

To date, GIE has received Declarations of Intent to Invest worth $1.25 billion. In theory, the entire decision-making process should not take longer than three months. In practice, approvals have taken somewhat longer. The Government is aware of this problem, though, and is working to correct it.

One hundred per cent foreign ownership is permissible. Investors are guaranteed full repatriation of dividends and earnings. They may transfer abroad capital from the sale or liquidation of a company.





The ceasefire accord will markedly change business conditions. Already, the Government has received over $1 billion in investment proposals.

Coca Cola (Belgium) and Volvo are two investors recently approved by the Government. Coca Cola is renovating and expanding a soft drinks plant outside Luanda. When operational, the plant will help reduce Angola's dependence on imported soft drinks and save foreign exchange.

Volvo will produce automobiles, trucks and buses for sale in the Angolan market. It will, in addition, look to vehicle maintenance and the supply of spare parts. The company will also rehabilitate a large number of commercial vehicles already in the country.

Both companies will train a significant number of Angolans for skilled technical and managerial positions.

Since 1989, UNCTC has provided assistance to the Government of Angola in attracting investment. Funded by UNDP, the programme includes assistance in negotiating with potential investors, advice on privatization, training in project and financial evaluation, the development of management information systems, and study tours and seminars. ■

Does Liberalization Work? Not by Itself

Economic strength, not the openness of investment regimes, is the primary determinant of where foreign investors will locate. In designing measures to attract equity capital from abroad, countries need to focus on strengthening their economic and infrastructural base to encourage long-term growth.

Two recent UNCTC studies find that market possibilities are the main determinant of corporate boardroom decisions. Both investigate the factors that influence where transnationals locate, looking closely at changes in host country regulations. Removing investment restrictions, they say, is effective only when there is economic growth or underlying development potential.

In the years from 1977 to 1987, *Government Policies and Foreign Direct Investment* identifies 321 changes in foreign direct investment policy world-wide. Most occurred in the area of taxes, subsidies and fiscal incentives. Performance requirements saw the least change, particularly among developing countries.

Newly industrializing countries made the largest number of liberalizations per capita, and concentrated on lifting foreign ownership restrictions. Other developing countries focused on loosening sectoral limitations.

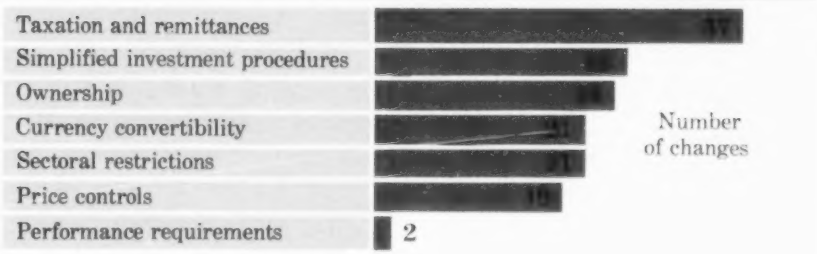
Despite the liberalizations developing countries undertook through the 1980s, investments increased in but a handful. They concentrated in the four newly industralizing Asian economies and in China. In each of these cases, policy changes were made against a background of strong economic and consumer demand growth.

Reviewing the empirical literature, *The Determinants of Foreign Direct Investment: A Survey of the Evidence* finds that companies are investing abroad to serve local or regional markets. Given changes in production technology, cheap labour for third-country export is no longer the attraction it was a few years ago. In deciding where to site affiliates, investors are looking for efficient supply and distribution networks, sound infrastructure, skilled labour and the possibility of demand growth.

Moreover, where a transnational chooses to locate has more to do with its own competitive strengths than with the investment incentives it is offered. In seeking investors, countries might target transnationals whose competitive advantages they best match, and continue to build their own strengths. ■

Developing Country Liberalizations

(1977 to 1987)



Government Policies and Foreign Direct Investment. United Nations publication, Sales No. E.91.II.A.20. *The Determinants of Foreign Direct Investment: A Survey of the Evidence.* United Nations publication, Sales No. E.92.II.A.2. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.

The United Nations Centre on Transnational Corporations is an autonomous body within the United Nations Secretariat. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, the Centre seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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